Supreme Court, U.S.
FILED

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No. _____

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In The

Supreme Court of the United States

JOHNNY PAUL YOUNG,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Is the tax on compensation received on account of personal non-physical injuries created by the 1996 change to 26 United States Code Section 104(a)(2) unconstitutional because:

1. It violates the prohibition against direct or capitation taxes found at Article I, Section 9, Clause 4?

2. It violates the equal protection component of the due process clause of Amendment V?

May the defenses of sovereign immunity or failure to exhaust administrative remedies ever defeat the jurisdiction of an Article III Court over a Constitutional challenge to a federal statute?

STATEMENT PURSUANT TO RULE 29.6

The Petitioner is Johnny Paul Young.

The Respondent is the United States of America.

Neither party has any parent companies nor non-wholly owned subsidiaries.

TABLE OF CONTENTS

	Page
Questions Presented	i
Statement Pursuant to Rule 29.6	ii
Table of Authorities	v
Opinions Below	1
Statement of Jurisdiction	1
Constitutional and Statutory Provisions Involved	2
Statement of the Case	4
Reasons for Granting the Writ	9
I. The Constitutionality Of The Tax On Compensation For Non-Physical Personal Injuries Created By The 1996 Amendment To 26 United States Code §104(a)(2) Is An Important Question Of Federal Law That This Court Should Decide	9
II. The Availability Of "Sovereign Immunity" As A Valid Defense To The Judicial Review Of A Constitutional Challenge To A Statute Is An Important Question Of Federal Law That This Court Should Decide	17
III. The Court Of Appeals Has Entered A Decision In Conflict With The Decisions Of Another Court Of Appeals On The Important Federal Question Of Whether Constitutional Questions Must First Be Presented To An Administrative Agency As A Predicate For Their Adjudication By An Article III Court	19
Conclusion	20

TABLE OF CONTENTS – Continued

Page

Appendix

Opinion of the United States Court of Appeals for the Sixth Circuit, filed on April 28, 2003 ..... App. 1

Memorandum Opinion of the United States District Court for Western Kentucky, entered September 26, 2001 ..... App. 8

Order of the United States District Court for Western Kentucky entered on September 26, 2001 ..... App. 14

Order of the United States Court of Appeals for the Sixth Circuit, entered on July 8, 2003 ..... App. 15

Letter of Dan Myers, Field Director, Accounts Management, Internal Revenue Service, to Johnny P. Young, dated May 16, 2001 ..... App. 17

TABLE OF AUTHORITIES

Page

CONSTITUTIONAL PROVISIONS

Article I, Section 9, Clause 4 ..... 2, 10, 11, 13

Article III 2

Amendment V 2, 13

STATUTORY PROVISIONS

26 United States Code Section 104(a)(2) ..... *passim*

26 United States Code Section 7422(a) 3, 5, 18

ADMINISTRATIVE REGULATION

26 Code of Federal Regulations Section 301.6402-2(b)(1) 3

CASES

American National Insurance Co. v. Commissioner of Internal Revenue, 91 F.2d 705 (5th Cir. 1937) 11

Commissioner v. Glenshaw Glass Company, 348 U.S. 426, 75 S.Ct. 473, 99 L.Ed. 483 (1955) 12

Commissioner of Internal Revenue v. Schleir, 515 U.S. 323, 115 S.Ct. 2159, 132 L.Ed.2d 294 (1995) 16

Durkee v. Commissioner of Revenue, 162 F.2d 184 (6th Cir. 1947) 10

Gertz v. Welch, 418 U.S. 323, 94 S.Ct. 2997, 41 L.Ed.2d 769 (1974) 5, 11, 13, 14

Gilbert v. National Transportation Safety Board, 80 F.3d 365 (9th Cir. 1996) 19

TABLE OF AUTHORITIES – Continued

Page

Howard v. Federal Aviation Administration, 17 F.3d 1213 (9th Cir. 1994) 19

Kohl v. United States, 226 F.2d 381 (7th Cir. 1953) 10

Marbury v. Madison, 5 U.S. (1 Cranch) 137, 2 L.Ed. 60 (1803) 18

Massachusetts Board of Retirement v. Murgia, 427 U.S. 307, 96 S.Ct. 2562, 49 L.Ed.2d 520 (1976) 15

Metropolis Theatre Co. v. City of Chicago, 228 U.S. 61, 33 S.Ct. 441, 57 L.Ed. 730 (1913) 17

O'Gilvie v. United States, 514 U.S. 79, 117 S.Ct. 452, 136 L.Ed.2d 454 (1996) 6, 9, 11

Regan v. Taxation with Representation of Washington, 461 U.S. 540, 103 S.Ct. 1997, 76 L.Ed.2d 129 (1983) 12

Simmons v. United States, 306 F.2d 160 (4th Cir. 1962) 10

United States v. Burke, 504 U.S. 229, 112 S.Ct. 1876, 119 L.Ed.2d 34 (1992) 16

United States v. Koshland, 208 F.2d 696 (9th Cir. 1953) 10

PETITION FOR A WRIT OF CERTIORARI

The petitioner, Johnny Paul Young, respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit in this case.

OPINIONS BELOW

The District Court's opinion (per Russell, D.J.) granting the respondent's motion to dismiss (Appendix, hereinafter APX, P. 8), is not published. The Court of Appeals' opinion (APX, P. 1), per Daughtrey, C.J., joined by Gibbons, C.J., and Mills, D.J., sitting by designation, is published at 33 F.3d 893. The Court of Appeals' Order denying rehearing and rehearing en banc (APX, P. 15), is not otherwise published.

STATEMENT OF JURISDICTION

The Court of Appeals entered its opinion on April 23, 2003, and denied rehearing and rehearing en banc on July 8, 2003. Petitioner invokes this Court's jurisdiction under 28 U.S.C. §1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Constitutional Provisions

ARTICLE I, Section 9, Clause 4

Powers denied Congress: No Capitation, or other direct Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken.

ARTICLE III

Section 1. Judicial Power

The judicial Power of the United States, shall be vested in one supreme Court, and in such inferior Courts as the congress may from time to time ordain and establish. . . .

Section 2. Extent of judicial power; Supreme Court; Time and places of trial.

The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States . . . [and] to Controversies to which the United States shall be a party . . .

AMENDMENT V

No person shall . . . be deprived of life, liberty, or property, without due process of law . . .

Statutory Provisions

26 UNITED STATES CODE
Section 104(a)(2), before 1996

The amount of any damages (other than punitive damages) received by suit or agreement as lump sums or as periodic payments on account of personal injuries or sickness [is exempt from the income tax].

26 UNITED STATES CODE Section 104(a)(2), 1996 and after as amended by PUBLIC LAW 104-188, Section 1605(a)-6.

The amount of any damages (other than punitive damages) received by suit or agreement as lump sums or as periodic payments on account of personal physical injuries or physical sickness [is exempt from the income tax].

26 UNITED STATES CODE Section 7422(a)

No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Secretary, according to the provisions of law in that regard and the regulations of the Secretary established in pursuance thereof.

26 CODE OF FEDERAL REGULATIONS
Section 301.6402-2(b)(1)

. . . the claim [for a refund] must set forth in detail each ground upon which a credit or refund is claimed . . . A claim which does not comply with this paragraph will not

be considered for any purpose as a claim for refund or credit.

STATEMENT OF THE CASE

In April, 1998, the Petitioner, Johnny Paul Young, sued his former employer, Sumitomo Electric Wiring Systems, Inc., in the Warren Circuit Court of the Commonwealth of Kentucky. Young alleged that Sumitomo had subjected him to, " . . . intimidation, discrimination, and terroristic threatening," and sought damages for, " . . . lost wages, humiliation, embarrassment, personal indignity, and mental and emotional distress," from Sumitomo (Opinion of the Court of Appeals, P. 2; Appendix to this Petition, hereinafter APX, P. 3).

Sumitomo and Young settled the lawsuit in March, 1999. Sumitomo paid Young's attorneys $30,000 and Young $60,000, " . . . less the minimum required deductions and withholdings," which Sumitomo calculated at $16,997 and paid to the Internal Revenue Service (*Id.*, APX, P. 3).

Young then filed an amended return with the IRS in which he sought a refund of the $16,997 that Sumitomo had withheld for the IRS from his portion of the settlement with it.

Young's attorney informed the IRS that he believed that 26 United States Code §104(a)(2), which had been changed in 1996 to remove the exemption from taxation for just such awards as he had received, was Unconstitutional. Young asserted that the government's efforts to tax damaged personal non-physical interests while not

attempting to tax such interests when undamaged or any personal physical interests violated the equal protection component of the due process clause of the Fifth Amendment to the Constitution of the United States. He characterized the new tax as one, " . . . upon degradation and the degraded without any saving grace or proportion," (Complaint, Attachment 4, P. 3).

Petitioner Young indicated to the IRS that this Court has held that "personality interests," for damage to which he had received his settlement from Sumitomo, are entitled to the same basic Constitutional protection as property interests, or even life itself, citing *Gertz v. Robert Welch*, 418 U.S. 323, 342, 94 S.Ct. 2997, 3008, 41 L.Ed.2d 679 (1974) and related cases (*Id.*)

On May 16, 2001, the IRS disallowed Young's refund claim. The agency merely parroted 26 U.S.C. §104(a)(2) and stated that the money Young had received did not fall within the exclusion of, " . . . damages on account of personal physical injuries or physical sickness." It did not indicate in any manner that it had considered Young's Constitutional argument (Complaint, Attachment 5; APX, P. 17)

On June 27, 2001, Petitioner Young sued the United States in the federal District Court for Western Kentucky at Bowling Green, under the provisions of 26 U.S.C. §7422(a). His original Complaint alleged that 26 U.S.C. §104(a)(2), as amended in 1996, violated the equal protection component of the due process clause of the Fifth Amendment to the Constitution of the United States (Opinion of the Court of Appeals, P. 3; APX, P. 3).

The United States then filed a motion to dismiss Young's lawsuit. This pleading was basically a response to

Young's legal arguments to the IRS. Indeed, it was the first such response.

On September 11, 2001, Young filed a motion to amend his Complaint by adding the theory that the tax at issue is a direct or capitation tax in violation of Article I, Section 9, Clause 4, of the Constitution (Motion to Amend Complaint).

Also on September 11, 2001, Young filed a pleading that responded to the Motion to Dismiss and contained his arguments in favor of his "direct tax theory." Young suggested to the Court that it permit full briefing on this issue.

Young's arguments in support of the proposition that the tax at issue in this case was a prohibited direct tax were basically the same as those that appear later in this petition, although he did not cite *O'Gilvie v. United States*, 514 U.S. 79, 117 S.Ct. 452, 136 L.Ed.2d 454 (1996) [Response to Motion to Dismiss, Cross-Motion for Judgment on the Pleadings].

On September 26, 2001, the District Court dismissed Young's lawsuit. It agreed with the government's argument that it should not subject the tax at issue, or the classifications that it created, to the "strict scrutiny" equal protection analysis. It also held that Young had failed to show that there was no "rational basis" for the tax scheme that he was attacking. (Memorandum Opinion of the District Court, Pp. 3-5; APX, Pp. 10-12).

The District Court did consider Young's "direct tax" challenge to the tax at issue, but held that it was, " . . . not well-taken," apparently believing that the only form of direct tax is the "capitation" tax mentioned in Article I,

Section 9, Clause 4 of the Constitution (*Id.*, P. 2, note 3; APX, P. 9).

On October 1, 2001, the United States served an untimely response to Petitioner Young's direct tax argument (Reply and Response).

On October 22, 2001, the Petitioner appealed to the Untied States Court of Appeals for the Sixth Circuit (Notice of Appeal).

The United States filed no notice of appeal or cross-appeal.

The Court of Appeals held that the District Court had been without jurisdiction to adjudicate Petitioner's "direct tax" challenge to 26 U.S.C. §104(a)(2) [Opinion of the Court of Appeals, P. 3; APX, P. 4]. It rejected Petitioner's argument that both it and the District Court had, " . . . subject matter jurisdiction because the IRS cannot determine the constitutionality of a statute," and his argument that the Court of Appeals had jurisdiction to consider the "direct tax" argument, " . . . because the government failed to cross-appeal," (*Id.*, P. 4; APX, Pp. 4-5)

The Court of Appeals held that Petitioner was required to present his "direct tax" challenge to the IRS with his refund request because that was the only method available to take advantage of the fact that, "Congress has expressly waived sovereign immunity for suits against the United States by taxpayers seeking to recover refunds," (*Id.*, Pp. 3-4; APX, P. 4). According to the Court, Young's failure to use this "waiver of sovereign immunity" deprived both it and the District Court of any jurisdiction over his Constitutional challenge to 26 U.S.C. §104(a)(2).

The Court of Appeals did address Petitioner's argument that the challenged tax violated the equal protection component of the Fifth Amendment to the Constitution.

The Court refused to apply "strict scrutiny" to the tax scheme, opining that nothing in the statute, " . . . interfer[ed] with the exercise of a fundamental right such as freedom of speech, or employ[ed] a suspect classification, such as race," (*Id.*, P. 5; APX, P. 6). The Court held that the tax met the alternative "rational basis" test because there may be some, " . . . conceivable state of facts that would support it," (*Id.*, P. 6; APX, P. 6).

The only such "state of facts" recited by the Court was that which the government had presented to the District Court: that by removing the exemption from taxation for compensation received on account of non-physical personal injuries, "Congress sought to establish a uniform policy regarding taxation of damages awards and to reduce the amount of litigation regarding whether damages were taxable," (*Id.* P. 6; APX, P. 6).

Petitioner then sought a panel or en banc rehearing. He pointed out that the Court had ignored his challenge to the classification between damaged and undamaged personality interests inherent in 26 U.S.C. §104(a)(2)'s 1996 change. He also criticizes the opinion of the Court for relying upon the defense of sovereign immunity to avoid adjudicating his "direct tax" challenge to the tax at issue.

Even before Petitioner filed his rehearing request, the government asked that the Court publish its opinion, correctly pointing out that this was a case of first impression. The Court sustained the government's motion on April 28, 2003.

On July 8, 2003, the Court of Appeals denied, without opinion, the Petition for Rehearing (Order denying Rehearing; APX, Pp. 15-16).

REASONS FOR GRANTING THE WRIT

I.

THE CONSTITUTIONALITY OF THE TAX ON COMPENSATION FOR NON-PHYSICAL PERSONAL INJURIES CREATED BY THE 1996 AMENDMENT TO 26 UNITED STATES CODE §104(a)(2) IS AN IMPORTANT QUESTION OF FEDERAL LAW THAT THIS COURT SHOULD DECIDE.

As we have seen, this case presents the important question of whether or not the 1996 change in 26 U.S.C. §104(a)(2) violates the "equal protection" component of the due process clause to the Fifth Amendment to the Constitution of the United States, or Article I, Section 9, Clause 4 of that document, or both of these Constitutional provisions.

Prior to the 1996 change in the tax at issue, neither Congress nor the Internal Revenue Service nor the Treasury Department had ever sought to tax any sort of personal injury awards that included compensation for anything beyond lost wages, see *O'Gilvie v. United States*, *supra*, 117 S.Ct. at 453.

As the government noted to the Court of Appeals, this is the first challenge to the 1996 changes in the law.

Petitioner will now briefly summarize the reasons that he believes that any effort to tax compensation for

non-physical personal injuries is unconstitutional, thereby justifying this Court's granting this Petition.

* * *

Reason number one is that any effort to tax non-physical personal interests, or compensation received for damage to those interests, amounts to a direct tax in violation of Article I, Section 9, Clause 4, of the Constitution.

This Constitutional provision states that Congress may not levy any direct or capitation tax, except in proportion to the census.

The tax the Petitioner is challenging, of course, is not levied in proportion to the census.

How do we know that we are dealing with a direct tax in this case? It is because any tax upon private personality interests or upon money received as compensation for damages to those interests is a tax upon an asset and a tax upon any asset, whether tangible or intangible, is a direct tax, as we may see from a review of the cases.

No tangible property assets may be taxed, *United States v. Koshland*, 208 F.2d 636 (9th Cir. 1953); *Simmons v. United States*, 308 F.2d 160, 166 (4th Cir. 1962).

No tangible personal physical interests may be taxed because of the prohibition on "capitation" or "head" taxes found at Article I, Section 9, Clause 4 of the Constitution.

No intangible property interests, such as business goodwill, may be taxed, *Durkee v. Commissioner of Revenue*, 162 F.2d 184 (6th Cir. 1937). Even interests as intangible as the enjoyment of rights may not be taxed, *Kohl v. United States*, 226 F.2d 831, 834 (7th Cir. 1955).

As we have seen, the intangible personal non-physical rights that this Court has described as "personality interests," enjoy a level of Constitutional stature commensurate with that accorded to property, and even life interests, *Gertz v. Welch*, *supra*. Although there are no cases that specifically say so, therefore, it is quite apparent that these "personality interests," like business goodwill, may not be taxed under Article I, Section 9, Clause 4 of the Constitution, because they are an asset, albeit personal and intangible.

The money that Petitioner received from his former employer in this case was compensation for injury to his "personality interests."

Obviously, if assets themselves may not be taxed, neither may amounts received as compensation for injuries to them be taxed. Indeed, it is within the context of damage to assets that most of the cases cited above arose. The government apparently gave up any effort to tax the value of assets, much less assets themselves, with the case of *American Insurance Co. v. Commissioner of Internal Revenue*, 91 F.2d 705, 707 (5th Cir. 1937).

Shortly after the enactment of the Sixteenth Amendment in 1913, the Courts and even the Treasury Department concluded that money received as compensation for personal injuries was not subject to the income tax because it was a return of, " . . . a victim's lost, non-taxible capital," or "human capital," *O'Gilvie v. United States*, *supra*, 117 S.Ct. at 453. 26 U.S.C. §104(a)(2), of course, reflected this principle as to compensation for all forms of personal injuries until 1996, when it was amended to remove amounts received as compensation for non-physical personal injuries from its "exemption."

Because amounts received for any personal injury, physical or non-physical, are a return of human capital and not an, "... accession to wealth," *Commissioner v. Glenshaw Glass Company*, 348 U.S. 436, 438, 75 S.Ct. 473, 99 L.Ed. 483, *reh. denied*, 349 U.S. 925, 75 S.Ct. 657, 99 L.Ed. 1256 (1955), they are not subject to taxation. No "exemption" from taxation was ever necessary to make these amounts non-taxable. The lack of an "exemption" for amounts received as compensation for non-physical injuries since 1996 does not change this fact. Because the change in 26 U.S.C. §104(a)(2) purports to make such compensation taxable, it violates Article I, Section 9, Clause 4 of the Constitution.

* * *

Reason number two is that the effort to tax non-physical personal interests, or compensation received for damage to those interests, violates the due process clause of the Fifth Amendment to the Constitution of the United States.

This clause, of course, contains an "equal protection" component that requires our Courts to analyze federal government laws and actions the same way that they analyze state laws and actions under the equal protection clause of the Fourteenth Amendment to the Constitution of the United States, *Regan v. Taxation with Representation*, *supra*, 461 U.S. 540, 542, note 2.

There are two levels of scrutiny that this Court has fashioned for determining equal protection challenges such as the one at bar. One is the "strict scrutiny" analysis; the other is the "rational basis" standard.

Petitioner believes that the tax at issue in this case should be subjected to the "strict scrutiny" test.

The Court of Appeals declined to do so. It held that:

> . . . the statutory provision in question does not "interfere with the exercise of a fundamental right such as free speech, or employ a suspect classification such as race," (Opinion of the Court of Appeals, P. 5; APX, P. 6; citing *Regan v. Taxation with Representation of Washington*, 461 U.S. 540, 547, 103 S.Ct. 1997, 76 L.Ed.2d 129 (1983).

Petitioner disagrees.

Certainly the tax scheme at issue interferes with a fundamental right or interest: the right to be free from a direct tax!

Completely apart from Petitioner's more specific argument that the tax at issue in this case violates Article I, §9, Clause 4 of the Constitution, that tax should at the very least be subjected to strict scrutiny when analyzed as a potential denial of the equal protection of the laws. After all, free speech is not per se protected by the equal protection clause of the Fourteenth Amendment or its "federal counterpart" in the due process clause of the Fifth Amendment. It is protected by the First Amendment.

Furthermore, our Constitution, in the Fifth Amendment's due process clause itself, clearly recognizes that private personality interests are quite "fundamental." As this Court said in *Gertz v. Welch, supra*, 418 U.S. at 342, "The protection of private personality, like the protection of life itself," is entitled to, " . . . recognition as a basic of our constitutional system."

Private personality interests consist of an individual's mental and emotional equanimity, reputation, and related attributes, *Id.* It was for damage to just such interests that the Petitioner received compensation from his former employer in this case, and from which the United States has wrongfully collected taxes.

Petitioner believes that the government has sought to tax what amounts to his soul. Such a tax should be subject to at least the same level of scrutiny as would be an effort to tax his speech.

In addition to interfering with a fundamental interest, the tax at issue employs suspect classifications.

26 U.S.C. §104(a)(2) effectively taxes only damaged personality interests, while no part of the tax code purports to tax undamaged personality interests. Furthermore, the statute exempts from taxation damaged physical personal interests and, of course, no portion of the tax code now purports to tax undamaged personal physical interests.

These classifications themselves, completely apart from the substantive interests that is their subject, appear to the Petitioner to be so invidious as to require strict scrutiny.

The Courts below appeared to believe that those rights or interests entitled to the protection of "strict scrutiny" are restricted to those few areas directly acknowledged in existing federal case law. This is certainly not so.

This Court has held that virtually any recognizable interest or class or group of rights may be considered worthy of the shield of "strict scrutiny" analysis if the

government is seeking to, " . . . saddle [the group or interest] with such disabilities . . . as to command extraordinary protection from the majoritarian process," *Massachusetts Board of Retirement v. Murgia*, 427 U.S. 307, 313-314, 96 S.Ct. 2561, 2567, 49 L.Ed.2d 520 (1976). Certainly the tax scheme at issue in this case meets this criterion.

Neither the Courts below nor the United States argued that the challenged tax and the classifications it creates could survive strict scrutiny. They most certainly could not.

* * *

What we have here is a tax not only upon fundamental and Constitutionally protected interests, but a classification scheme that permits the taxation of degradation and the degraded. Petitioner can envision no possible justification for taxing anything simply because it is incorporeal and damaged, and for no other apparent reason.

In short, not only is it true that the changes to 26 U.S.C. §104(a)(2) cannot withstand strict scrutiny, but it is even true that they cannot survive the "rational basis" analysis.

The Courts below held that the challenged tax scheme was justified by Congress's stated reason for enacting it, which is that Congress wanted to:

> . . . establish a uniform policy regarding taxation of damage awards and to reduce the amount of litigation regarding whether damage awards were taxable (Opinion of the Court of Appeals, P. 6; APX, P. 6; Opinion of the District Court, P. 4; APX, P. 12).

Petitioner believes that he conclusively demonstrated to the Courts below that there never was a "non-uniform" policy regarding the taxation of damage awards and that any questions that may have arisen regarding the taxation of such awards had been conclusively settled by 1996.

This was not a particularly difficult undertaking.

The United States admitted in its motion to dismiss to the District Court that Courts had interpreted the exclusion from taxes for amounts received as compensation for all personal injuries under 26 U.S.C. §104(a)(2), as written before 1996:

> . . . broadly to cover awards for personal injury that did not relate to physical injury or sickness such as mental or emotional distress (Motion to Dismiss, P. 2).

The only litigation remotely related to this issue involved not the obvious non-taxability of *all* damages awards for *all* personal injuries, but whether certain federal anti-discrimination and civil rights laws contained remedies that permitted the recovery of damages. This Court addressed this issue in the cases of *United States v. Burke*, 504 U.S. 229, 112 S.Ct. 1876, 119 L.Ed.2d 34 (1992) and *Commissioner of Internal Revenue v. Schleir*, 515 U.S. 323, 115 S.Ct. 2159, 132 L.Ed.2d 294 (1995).

Congress itself removed any possibility of litigation about the nature of federal civil rights and discrimination remedies when it basically made all such actions into statutory torts in 1992, see 42 United States Code §1985.

Petitioner fails to see how it can be said that there is a rational basis for a law when the reason stated by the legislature for passing it was demonstrably false.

* * *

Perhaps this is one of the rare cases where there is no real need to debate the level of scrutiny that should be applied in resolving Petitioner's equal protection challenge to the tax at issue. Because that tax invidiously affects interests so important and creates classifications so odious, it may be fair to say that it is "palpably arbitrary," and therefore a denial of the equal protection of the laws, *Metropolis Theatre Co. v. City of Chicago*, 228 U.S. 63, 69, 33 S.Ct. 441, 57 L.Ed. 730 (1913).

II.

THE AVAILABILITY OF "SOVEREIGN IMMUNITY" AS A VALID DEFENSE TO THE JUDICIAL REVIEW OF A CONSTITUTIONAL CHALLENGE TO A STATUTE IS AN IMPORTANT QUESTION OF FEDERAL LAW THAT THIS COURT SHOULD DECIDE.

The Court of Appeals' holding that "sovereign immunity" stood between the Petitioner and the Courthouse as to Petitioner's "direct tax" theory is a new twist upon the mostly discredited "administrative exhaustion" requirement for bringing a case to Court.

It is, however, probably a twist of first impression for this Court in a case involving a Constitutional challenge to a statute.

As we have seen, the Court of Appeals held that Petitioner was required by the doctrine of "sovereign immunity," to present his Constitutional challenges to the tax at issue to the IRS as a condition precedent for seeking adjudication of the challenges.

The Court cited as authority for this proposition 26 U.S.C. §7422(a), under which Petitioner filed this lawsuit, and the administrative regulations related to this statute (Opinion of the Court of Appeals, P. 4; APX, P. 4).

While Petitioner certainly has no quarrel with the validity of the cited statute and regulations, he believes that they simply have no application to Constitutional litigation of the particular sort represented by this case.

The Internal Revenue Service has no power to adjudicate Constitutional challenges to any statute. Article III of the Constitution exclusively vests such authority in the United States *courts* and in no other bodies or agencies.

Neither 26 U.S.C. §7422(a) nor any of the regulations related to it conflict with this principle unless we pretend that Article III and the whole separation of powers doctrine upon which our republican form of government was established does not apply in a case such as this, or is a chimera.

While Congress may certainly enact laws, including laws that describe the manner in which the citizens may gain access to the Courts, and administrative agencies may promulgate regulations to give effect to the statutes, neither Congress nor any administrative agency may finally say whether a law is Constitutional. This is the clear meaning of *Marbury v. Madison*, 5 U.S. (1 Cranch), 137, 176, 2 L.Ed. 60 (1803) and Article III of the Constitution itself.

If citizens may only challenge the constitutionality of statutes pursuant to a congressional "waiver" of sovereign immunity, Congress could bar all such challenges by the simple expedient of not enacting laws permitting them!

The right to seek a judicial determination of the Constitutionality of a statute cannot be dependent in any manner upon administrative or Congressional grace. Petitioner believes that the contrary proposition postulated by the Court of Appeals merits the granting of this Petition, so that the proposition may be put to rest.

III.

THE COURT OF APPEALS HAS ENTERED A DECISION IN CONFLICT WITH THE DECISIONS OF ANOTHER COURT OF APPEALS ON THE IMPORTANT FEDERAL QUESTION OF WHETHER CONSTITUTIONAL QUESTIONS MUST FIRST BE PRESENTED TO AN ADMINISTRATIVE AGENCY AS A PREDICATE FOR THEIR ADJUDICATION BY AN ARTICLE III COURT.

If viewed merely as a novel restatement of the old "administrative exhaustion" requirement for coming to Court, the holding of the Court of Appeals that the Courts had no jurisdiction over Petitioner's "direct tax" challenge to 26 U.S.C. §104(a)(2), is in direct conflict with opinions of the United States Court of Appeals for the Ninth Circuit.

In *Howard v. Federal Aviation Administration*, 17 F.3d 1213, 1218 (9th Cir. 1994), the Court held that challenges to the Constitutionality of an agency *regulation* lie outside the cognizance of that agency and therefore need not be "administratively exhausted."

In *Gilbert v. National Transportation Safety Board*, 80 F.3d 364, 376 (9th Cir. 1996), the Court held that the same rule applied to Constitutional *claims*.

In this case, of course, the Constitutional challenge is of a much greater magnitude than a challenge to a regulation or a mere claim of unconstitutional treatment. It is a challenge to a Congressional statute.

The Court of Appeals ignored these opinions in this case. It cited no authority for the proposition that the IRS is somehow entitled to deference where other agencies are not. Indeed, it cited no cases for the proposition that sovereign immunity may ever be used to justify the application of an administrative exhaustion requirement in any case involving a *Constitutional* issue or question.

There are no such cases except for the one now before this Court. The opinion of the Court of Appeals in this case should not be permitted to stand.

CONCLUSION

It is difficult to imagine a case that presents as many important questions as this one. This Court should grant this Petition so that it may fully examine and settle these questions.

Respectfully submitted,

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RECOMMENDED FOR FULL-TEXT PUBLICATION
Pursuant to Sixth Circuit Rule 206

ELECTRONIC CITATION: 2003 FED App. 0204P (6th Cir.)
File Name: 03a0204p.06

UNITED STATES COURT OF APPEALS

FOR THE SIXTH CIRCUIT

JOHNNY PAUL YOUNG, *Plaintiff-Appellant* *v.* UNITED STATES OF AMERICA, *Defendant-Appellee.*	No. 01-6362

Appeal from the United States District Court
for the Western District of Kentucky at Bowling Green.
No. 01-00109 – Thomas B. Russell, District Judge.

Argued: March 25, 2003

Decided and Filed: April 28, 2003*

Before DAUGHTREY and GIBBONS, Circuit Judges;
MILLS, District Judge.**

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* This decision was originally issued as an "unpublished decision" filed on April 28, 2003. On May 16, 2003, the court designated the opinion as one recommended for full-text publication.

** The Honorable Richard Mills, United States District Judge for the Central District of Illinois, sitting by designation.

COUNSEL

ARGUED: Philip C. Kimball, Louisville, Kentucky, for Appellant. Kenneth L. Greene, UNITED STATES DEPARTMENT OF JUSTICE, Washington, D.C., for Appellee. **ON BRIEF:** Philip C. Kimball, Louisville, Kentucky, for Appellant. Kenneth L. Greene, Michael J. Haungs, UNITED STATES DEPARTMENT OF JUSTICE, Washington, D.C., for Appellee.

OPINION

MARTHA CRAIG DAUGHTREY, Circuit Judge. This appeal arises from a settlement agreement that plaintiff Johnny Paul Young entered into with his former employer, under which he was to receive $60,000, less his tax liability. The employer calculated Young's withholding tax and paid Young the remainder. Thereafter, Young sought a tax refund from the Internal Revenue Service on the theory that the relevant tax statute, 26 U.S.C. § 104(a)(2), is unconstitutional. The IRS rejected Young's claim for a refund, and Young brought this action against the United States. The government filed a motion to dismiss for failure to state a claim, which the district court granted, finding no merit to the contention that § 104(a)(2) is unconstitutional. We find no error and affirm.

FACTUAL AND PROCEDURAL BACKGROUND

The record in this case establishes that the plaintiff filed a complaint against his former employer, Sumitomo Electric Wiring Systems, Inc., alleging intimidation,

discrimination, and terroristic threatening. Young contended that, as a result of the company's wrongdoing, he suffered "lost wages, humiliation, embarrassment, personal indignity, and mental and emotional distress." In March 1999, Young and Sumitomo settled the complaint, and the company agreed to pay Young $60,000, "less the minimum required deductions and withholdings." The company calculated Young's tax obligations as $16,997, and paid Young the remainder.

After receiving payment, Young attempted to recover the money withheld as income tax from the settlement payment by filing an amended return and refund claim. In support of his claim, Young submitted a legal memorandum indicating his belief that the tax provision under which Sumitomo withheld the money, 26 U.S.C. § 104(a)(2), is unconstitutional. That Tax Code provision exempts from the calculation of gross income the amount of any damages received "on account of personal physical injury or physical sickness" but does not exempt payments for non-physical injuries or non-physical sickness. Although conceding that "Congress may tax anything it pleases," Young nevertheless argued that the distinction between physical and non-physical injury violates the equal protection component of the Fifth Amendment. In May 2001, the IRS rejected Young's argument and disallowed his refund claim.

In June 2001, Young filed suit against the United States in federal court, again maintaining that 26 U.S.C. § 104(a)(2) is a violation of equal protection. In response to the government's motion to dismiss for failure to state a claim, Young sought permission to amend his complaint to include arguments not made to the IRS or in his initial pleadings. Under the new theory, Young contended that

because the money he received under the settlement cannot be considered "income," the statute creates a "direct tax" in violation of Article I, § 9 of the United States Constitution. After considering both of Young's arguments, the district court granted the government's motion to dismiss. This appeal followed.

DISCUSSION

1. "Direct Taxation" Claim

We conclude, first, that the district court did not have subject-matter jurisdiction to entertain Young's "direct taxation" claim. Congress has expressly waived sovereign immunity for suits against the United States by taxpayers seeking to recover tax refunds. This waiver of sovereign immunity, however, is limited by the requirement that a taxpayer pursue administrative remedies before bringing suit against the government. *See* 26 U.S.C. § 7422(a). The administrative claim must be made "according to the provisions of law in that regard, and the regulations of the Secretary established in pursuance thereof." *Id.* Those regulations provide, in relevant part, that "[t]he claim must set forth in detail each ground upon which a credit or refund is claimed. . . . A claim which does not comply with this paragraph will not be considered for any purpose as a claim for refund or credit." 26 C.F.R. § 301.6402-2(b)(1). Of course, the law is well-settled that waivers of sovereign immunity must be strictly construed. *See United States v. Ranger Elec. Communications, Inc.*, 210 F.3d 627, 631 (6th Cir. 2000).

As we recently noted, "'Federal courts have no jurisdiction to entertain taxpayer allegations that impermissibly vary or augment the grounds originally specified by

the taxpayer in the administrative refund claim.'" *McDonnell v. United States,* 180 F.3d 721, 722 (6th Cir. 1999) (quoting *Charter Co. v. United States,* 971 F.2d 1576, 1579 (11th Cir. 1992)). This rule prevents surprise and adequately notifies the IRS of the claim and its underlying facts. *Id.* Accordingly, "[w]hen a party fails to state with specificity the grounds for the refund, the court is without jurisdiction to entertain the action." *Id.*

In the case at hand, Young did not raise the direct taxation argument during the administrative process. Nonetheless, Young argues that we have subject matter jurisdiction because the IRS cannot determine the constitutionality of a statute and because the government failed to cross appeal. Neither argument is meritorious. As noted above, the government's waiver of sovereign immunity is explicitly limited by the requirement that a taxpayer must first pursue administrative remedies, and Young, by his own admission, failed to raise the direct taxation claim during the administrative proceedings. Furthermore, a party may raise the question of subject-matter jurisdiction at any time. *See Franzel v. Kerr Mfg. Co.,* 959 F.2d 628, 629-30 (6th Cir. 1992). For this reason, we have no jurisdiction to consider the plaintiff's "direct tax" argument.

2. Equal Protection Claim

Young alleges that 26 U.S.C. § 104(a)(2) violates the equal protection component of the Fifth Amendment. That provision in the Tax Code was amended by the Small Business Job Protection Act of 1996 to provide that "gross income does not include . . . the amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as lump sums or as periodic

payments) on account of personal physical injuries or physical sickness. . . . " Prior to 1996, the Code did not require the injury or sickness to be physical. *See* 26 U.S.C. § 104(a)(2) (1994). The plaintiff asserts that this distinction between physical injury or sickness and non-physical injury or sickness for purposes of calculating gross income is unconstitutional.

Because the statutory provision in question does not "interfere with the exercise of a fundamental right, such as freedom of speech, or employ a suspect classification, such as race," the distinction that it creates is constitutional as long [sic] it bears a rational relationship to a legitimate government purpose. *Regan v. Taxation With Representation of Washington,* 461 U.S. 540, 547 (1983). The legislature has particularly broad discretion in creating distinctions in tax statutes, *see id.,* and "is not bound to tax every member of a class or none. It may make distinctions of degree having a rational basis, and when subjected to judicial scrutiny they must be presumed to rest on that basis if there is any conceivable state of facts which would support it." *Carmichael v. Southern Coal & Coke Co.,* 301 U.S. 495, 509 (1937) (citations omitted). "The burden is on the one attacking the legislative arrangement to negative every conceivable basis which might support it." *Madden v. Kentucky,* 309 U.S. 83, 88 (1940).

In this case, the plaintiff is simply unable to overcome this difficult burden. As the district court noted in dismissing his complaint, Congress sought to establish a uniform policy regarding taxation of damages awards and to reduce the amount of litigation regarding whether damage awards were taxable. *See* H.R. Conf. Rep. No. 104-737, at 300, *reprinted in* 1996 U.S.C.C.A.N. 1677; H.R.Rep. No.

104-586, at 142-43. The distinction between physical and non-physical injury is rationally related to these articulated government purposes and, as a result, Young's equal protection claim, as a matter of law, must fail.

CONCLUSION

For the reasons set out above, we AFFIRM the judgment of the district court dismissing the plaintiff's complaint for failure to state a cause of action.

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF KENTUCKY
BOWLING GREEN DIVISION
CIVIL ACTION NO. 1:01CV-109-R

JOHNNY PAUL YOUNG PLAINTIFF

v.

UNITED STATES OF AMERICA DEFENDANT

MEMORANDUM OPINION AND ORDER

This matter is before the Court on the motion of the Defendant, the United States of America (the "Government") to dismiss (dkt # 2). For the reasons stated below, this motion is GRANTED.

BACKGROUND

The Plaintiff, Johnny Paul Young ("Young"), received $60,000 by way of a settlement agreement entered into among himself, his prior attorney, and his former employer, Sumitomo Electric Wiring Systems, Inc. ("SEWS"). This settlement represented an agreement regarding a discrimination lawsuit brought by Young against SEWS. As part of paying the settlement, SEWS withheld some $16,997 as the income taxes it calculated as due and owing on the settlement amount. This withholding [1] reflected the 1996 amendments to 26 U.S.C. § 104(a)(2) provided in the Small Business Job Protection Act of 1996. As amended,

[1] There is no apparent dispute as to the dollar amount of the withholding. Nonetheless, the Court expresses no opinion as to the mathematical correctness of the $16,997 figure.

§ 104(a)(2) only allows exclusion from gross income of amounts received in tort-like actions "on account of personal *physical* injuries or *physical* sickness." 26 U.S.C. § 104(a)(2) (emphasis added). Since Young's injuries (apparently) were not of a physical nature, the amount was withheld from the settlement.

Young currently seeks the refund of that amount. He argues that the distinction made in § 104(a)(2) is a violation of equal protection under the Fifth Amendment.[2] He also contends that the amendment to the statute violates Article I, § 9, cl. 4, which provides that "No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directly to be taken."[3] By way of response, the Government points to the broad powers afforded to Congress in both collecting taxes and in determining what items of income may be excluded from that income. According to the Government, no cause of action lies since the distinction drawn by the Congress passes "rational basis" scrutiny.

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[2] "The Due Process Clause [of the Fifth Amendment] imposes on the Federal Government requirements comparable to those that the Equal Protection Clause of the Fourteenth Amendment imposes on the states." *Regan v. Taxation with Representation of Washington*, 461 U.S. 540, 542, n.2, 103 S. Ct. 1997, 1999, n.2, 76 L. Ed. 2d 129 (1983) (citation omitted).

[3] The Court finds this argument not well taken. A "capitation" is a direct tax based solely on one's status, and is most often epitomized by a poll tax. Considering the large number of cases which consider discrimination settlements "income" subject to taxation within the broad ambit of 26 U.S.C. § 61(a), *see, e.g., Commissioner of Internal Revenue v. Schleier*, 515 U.S. 323, 115 S. Ct. 2159, 132 L. Ed. 2d 294 (1995); *United States v. Burke*, 504 U.S. 229, 112 S. Ct. 1867, 119 L. Ed. 2d 34 (1992), the Court finds that the tax withheld by the Internal Revenue Service in this case is not a "capitation."

STANDARD

A motion to dismiss under Fed.R.Civ.P. 12(b)(6) should be granted only if "there is no set of facts that would allow plaintiff to recover." *Persian Galleries, Inc. v. Transcontinental Ins. Co.,* 38 F.3d 253, 258 (6th Cir. 1994). "When considering a motion to dismiss pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure, the district court must accept all of the allegations in the complaint as true, and construe the complaint liberally in favor of the plaintiff." *Lawrence v. Chancery Court of Tennessee,* 188 F.3d 687, 691 (6th Cir. 1999) (citing *Miller v. Currie,* 50 F.3d 373, 377 (6th Cir. 1995)). However, a "complaint must contain either direct or inferential allegations respecting all the material elements to sustain a recovery under some viable legal theory." *Andrews v. Ohio,* 104 F.3d 803, 806 (6th Cir. 1997) (citing *In re DeLorean Motor Co.,* 991 F.2d 1236, 1240 (6th Cir. 1993)).

DISCUSSION

"As the Supreme Court has oft repeated, [Section 61(a)] is to be construed liberally 'in recognition of the intention of Congress to tax all gains except those specifically exempted.'" *Greer v. United States,* 207 F.3d 322, 326 (6th Cir. 2000) (quoting *Commissioner v. Glenshaw Glass Co.,* 348 U.S. 226, 430, 75 S. Ct. 473, 476, 99 L.Ed. 483 (1955)). The Supreme Court has "also emphasized the corollary to § 61(a)'s broad construction, namely the default rule of statutory interpretation that exclusions from income must be narrowly construed." *Schleier,* 515 U.S. at 328, 115 S. Ct. at 2163 (citations omitted). This stems from a recognition by the Supreme Court that deductions from income are matters of legislative grace, "and Congress can, of course, disallow them as it chooses."

Commissioner of Internal Revenue v. Sullivan, 356 U.S. 27, 28, 78 S. Ct. 512, 514, 2 L.Ed.2d 559 (1958). *See also New Colonial Ice Co. v. Helvering,* 292 U.S. 435, 440, 54 S. Ct. 788, 790, 78 L. Ed. 1348 (1934) ("Whether and to what extent deductions shall be allowed depends upon legislative grace; and only as there is a clear provision therefor can any particular deduction be allowed.").

"Legislatures have especially broad latitude in creating classifications and distinctions in tax statutes" and the Supreme Court has historically overturned equal protection challenges to taxation legislation. *Regan,* 461 U.S. at 547, 103 S. Ct. at 2002.

> The broad discretion as to classification possessed by a legislature in the field of taxation has long been recognized . . . in taxation, even more than in other fields, legislatures possess the greatest freedom in classification. Since the members of a legislature necessarily enjoy a familiarity with local conditions which this Court cannot have, the presumption of constitutionality can be overcome only by the most explicit demonstration that a classification is a hostile and oppressive discrimination against particular persons and classes. The burden is on the one attacking the legislative arrangement to negative every conceivable basis which might support it.

Id., at 547-48, 103 S. Ct. at 2002 (quoting *Madden v. Kentucky,* 309 U.S. 83, 87-88, 60 S. Ct. 406, 407-08, 84 L. Ed. 590 (1940).[4] "Neither due process nor equal protection

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[4] This reflects so-called "rational basis" standard of review. *See Regan,* 461 U.S. at 547, 103 S. Ct. at 2001 ("Generally, statutory

(Continued on following page)

imposes upon a state any rigid rule of equality in taxation." *Carmichael v. Southern Coal & Coke Co.*, 301 U.S. 495, 509, 57 S. Ct. 868, 872, 81 L. Ed. 1245 (1937) (citations omitted). "A legislature is not bound to tax every member of a class or none. It may make distinctions of degree having a rational basis, and when subjected to judicial scrutiny they must be presumed to rest on that basis if there is any conceivable state of facts which would support it." *Id.* (citations omitted).

According to the legislative history that accompanies the amendments to § 104(a)(2), the Congress sought to establish a uniform policy regarding taxation of damages awards and prevent, or at least reduce, litigation regarding the question of whether or not damage awards were taxable. *See* H.R. Conf. Rep. No. 104-737, at 300, *reprinted in* 1996 U.S.C.C.A.N. 1677; H.R.Rep. No. 104-586, at 142-43 ("The confusion as to the tax treatment of damages received in cases not involving physical injury or physical sickness has led to substantial litigation"). The Court finds that providing certainty to taxpayers is a "rational" basis for making distinctions for tax deductions, and the certainty provided by the distinction in § 104(a)(2) is not a violation of equal protection.

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classifications are valid if they bear a rational relation to a legitimate governmental purpose."). The Court finds this is the proper standard of review in this case, as it has not been shown that the distinction made by § 104(a)(2) impacts a "fundamental right, such as freedom of speech, or employ[s] a suspect classification, such as race." *Id.* (citation omitted).

This is the 25 day of September, 2001.

/s/ Thomas B. Russell
Thomas B. Russell, Judge
United States District Court

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF KENTUCKY
BOWLING GREEN DIVISION
CIVIL ACTION NO. 1:01CV-109-R

JOHNNY PAUL YOUNG PLAINTIFF

v.

UNITED STATES OF AMERICA DEFENDANT

ORDER

This matter having come before the Court on Defendant's motion to dismiss (dkt # 2), the Plaintiff having responded thereto (dkt # 3), and the Court otherwise being sufficiently advised,

IT IS ORDERED:

Defendant's motion to dismiss (dkt # 2) is **GRANTED**. This case is **DISMISSED WITH PREJUDICE**.

This is a final and appealable order. There is no just cause for delay.

Entered this 25 day of September, 2001.

/s/ Thomas B. Russell
Thomas B. Russell, Judge
United States District Court

cc: Counsel of Record
Kimball
Wheatley

No. 01-6362

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

JOHNNY PAUL YOUNG, Plaintiff-Appellant, v. UNITED STATES OF AMERICA, Defendant-Appellee.	)	ORDER (Filed Jul. 08, 2003)

BEFORE: DAUGHTREY and GIBBONS, Circuit Judges; and MILLS,* District Judge.

The court having received a petition for rehearing en banc, and the petition having been circulated not only to the original panel members but also to all other active judges of this court, and no judge of this court having requested a vote on the suggestion for rehearing en banc, the petition for rehearing has been referred to the original panel.

The panel has further reviewed the petition for rehearing and concludes that the issues raised in the petition were fully considered upon the original submission and decision of the case. Accordingly, the petition is denied.

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* Hon. Richard Mills, Senior United States District Judge for the Central District of Illinois, sitting by designation.

ENTERED BY ORDER
OF THE COURT

/s/ Leonard Green
Leonard Green, Clerk lm

(LOGO) Department of the Treasury
Internal Revenue Service

CINCINNATI, OH 45999

In reply refer to: 1758004380
May 16, 2001 LTR 105C
406-60-3191 199912 30
00647

JOHNNY P & SANDRA J YOUNG
106 FORRESTER RD
GLASGOW KY 42141-5034060

CERTIFIED MAIL

Taxpayer Identification Number:	406-60-3191
Kind of Tax:	Income
Amount of Claim(s):	$ 16,997.00
Date Claim(s) Received:	Jan. 27, 2001
Tax Period(s):	Dec. 31, 1999

Dear Taxpayers:

This letter is your legal notice that we have disallowed your claim(s). We can't allow your claim(s) for refund or credit for the period(s) shown above for the reason(s) listed below.

Money received as damages on account of personal physical injuries or physical sickness are excludable from income per Code Section 104(a)(2); however, payments that are a settlement of back pay and liquidated damages are not excludable.

This payment was in the nature of severance pay rather than compensation for personal injury, and does not appear to be deductible based upon the agreement.

You may send us a new claim if you have information that wasn't included on your original claim for refund or credit.

However, we must receive this information within 3 years from the original filing of the return.

If you want to appeal our decision to disallow your claim, you must provide a brief written statement of the issues you don't agree with. The facts contained in the written statement should be detailed and complete, including names, amounts, locations, etc.

You should include the following:

1. A statement that you want to appeal the disallowance.
2. Your name, address, and a telephone number where you can be contacted during the day.
3. A statement of facts supporting your reasons for disputing the disallowance.
4. A statement outlining the law or other authority that supports your claim.

You must declare that the statement of facts is true under penalties of perjury. You may do this by adding the following statement and signing it:

> "Under penalties of perjury, I declare that the facts presented in my written appeal are, to the best of my knowledge and belief, true, correct, and complete."

An attorney, certified public accountant, or person enrolled to practice before the Internal Revenue Service may represent you. To have someone represent you, attach Form 2848, Power of Attorney and Declaration of Representative, (or similar written authorization) to your written statement.

If your authorized representative prepares the written statement, he or she should include a declaration stating

that he or she prepared the written statement and accompanying documents and whether he or she knows personally that the protest and accompanying documents are true and correct.

Please mail your request for an appeal to the address shown on this letter.

If you have any questions, please call our Customer Service area at 1-800-829-8815 between the hours of 12:00 AM and 11:59 PM. If you prefer, you may write to us at the address shown at the top of the first page of this letter.

Whenever you write, please include this letter and, in the spaces below, give us your telephone number with the hours we can reach you. Also, you may want to keep a copy of this letter for your records.

Telephone Number ( ) _____ Hours _____

Sincerely yours,

/s/ Dan Myers
Dan Myers, Field Dir.
Accounts Management

Enclosure(s):
Publication 1